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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	
National Exchange Carrier Association	CC Docket No. 93-123
Revisions to Tariff F.C.C. No. 5	Transmittal Nos. 518, 527 and 530
Universal Service Fund and Lifeline Assistance Rates	

AT&T OPPOSITION TO DIRECT CASE

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SUMMARY

In its Direct Case NECA fails to meet its burden of demonstrating that the increased Universal Service Fund ("USF") rates, which have been suspended and are the subject of this investigation, are just and reasonable. To the contrary, it appears that the USF rates at issue are excessive due to the improper resizing procedures used by NECA.

Specifically, as will be demonstrated below, NECA's procedures are deficient in at least two respects. First, it appears that NECA has improperly applied a modified version of the Commission's rule for quarterly update adjustments to all other types of USF resizing adjustments with the result that (i) both the overall USF revenue requirement and the USF subsidy to which individual LECs are entitled are overstated, and (ii) local exchange carrier's ("LECs") are given perverse incentives to misstate their annual cost data submission's to NECA. Second, NECA apparently does not follow its own audit procedures to detect errors in LEC-reported data which NECA uses to resize the USF, thereby, contributing to the USF's excessive growth.

Part 36, Subpart F of the Commission's rules specifies the procedures that NECA is to employ in calculating the USF as well as the procedures to be followed in relation to quarterly updates. Without specific sanction

in the Commission's rules, NECA utilizes a modified version of quarterly cost update rule which adjusts the NACPL and the company's USF subsidy only if the company's USF adjustment exceed $1 million. No other calculations are made for any other company. This procedure has the effect of increasing the USF subsidy flow for companies which file updates while understating the actual NACPL. Because of this an artifically high subsidy continues to flow to other companies. As a result, the overall size of the USF has been improperly increased by approximately $18 million.

In addition, the audit procedures used by NECA are inadequate because they have failed to identify and correct numerous errors in data submitted by LECs for inclusion in the USF calculation. For example, despite NECA's claim that it utilizes both "hard" and "soft" edit checks, on numerous occasions LECs have included amounts in loop categories which were greater that the total amounts which they assigned to the Total Central Office Transmission account.

Similar problems have be disclosed in the range validation techniques used by NECA. Thus, NECA failed to challenge a claim by New Jersey Bell of an increase of $332.7 in Transmission equipment assigned to the loop when New Jersey Bell's total Central Office Transmission Equipment had increased by only $62.7 million. In total, these failures in audit procedures have lead to an overstatement of the USF of an additional $24.9 million. These and other apparent errors in the rate development process indicate a total potential overstatement in the USF of $91.3 million.

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	)	
National Exchange Carrier Association	)	CC Docket No. 93-123
	)	
Revisions to Tariff F.C.C. No. 5	)	Transmittal Nos. 518, 527

reasonable.[2] To the contrary, it appears that the USF rates established in NECA Transmittals 518 and 527 are excessive due to the inappropriate resizing procedures employed by NECA. Consequently, the Commission should order NECA to correct its overstated USF revenue requirement and to refund the overstated amounts that interexchange carriers ("IXCs") have paid during the pendency of this investigation.[3] In aggregate, the overstatements included the 1993 USF rate under investigation total \$91.3 million.[4]

Specifically, NECA's Direct Case reveals that the procedures it employs in resizing the USF are deficient in at least two respects. First, it appears that NECA has improperly applied a modified version of the Commission Rule for quarterly update adjustments to all other types of USF individual LECs are entitled are overstated, and (ii) local

[redacted]

The USF revenue requirement is developed by NECA through an aggregation of cost data submitted by all LECs (other than average schedule companies which do not compute cost data). For the annual filing, NECA calculates the USF revenue requirement and the "expense adjustment" or subsidy to which individual LECs are entitled taking into account all costs specified under the Part 36 Rules for all LECs and making the comparison of study area loop-to-national average loop cost on that basis.[6]

As indicated in NECA's Direct Case, NECA separates subsequent (non-annual) cost adjustments, that may affect the USF subsidy to which an individual LEC is entitled and the overall revenue requirement of the USF fund, into various categories.[7] Quarterly updates are LEC-initiated

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(footnote continued from previous page)

LEC based on a comparison of its loop costs (as calculated per the study area loop cost formula in Part 36.621), to the national average loop cost (as calculated per the formula in Part 36.622(a)) (see Part 36.631(c) and (d)). In November, NECA makes its annual USF tariff filing, establishing the USF rates to be paid by IXCs beginning January 1 of the following year. In May, NECA makes its midyear tariff filing, which recomputes the USF tariff rate to be paid by IXCs effective July 1, based on a recomputed USF revenue voluntary adjustments to capture prospective cost increases on a one-quarter rolling forward basis (<u>see</u> Part 36.612). Other types of cost adjustments include errors and omissions, which are either retrospective LEC-initiated voluntary corrections or NECA-initiated corrections. Other adjustments reflect cost changes due to study area mergers, sales of assets, LEC conversions from average schedule to cost companies, as well as administrative adjustments, for example, to reflect over or undercollection of USF tariff years, non-quarterly cost changes accounted for the lion's share (70 to 100 percent) of all USF resizing adjustments.[10] For these reasons, it is critical that the procedures employed by NECA for non-quarterly resizing adjustments accurately reflect actual costs and do not create perverse incentives for the LECs.

The Commission Rules set forth the procedures that NECA is to employ to recalculate the USF subsidy for LECs filing quarterly updates. Part 36.622 requires NECA to recalculate the national average unseparated loop cost per working loop ("NACPL") to reflect LEC optional quarterly cost updates (regardless of dollar amount) (Part 36.622(a)(1)), to recalculate the study area cost per loop for each LEC that filed a quarterly cost update (Part 36.622(b)) and, based on a comparison of the LEC's revised study area loop cost-to-the new NACPL, to establish the additional interstate expense allocation permitted to the extent the filing LEC's study area loop cost exceeds the recomputed national average (Part 36.622(a)(2)).[11] At the

(footnote continued from previous page)

Table 3. Of the $27.8 million, $14.6 million relates to the 11/92 rates that are the subject of this investigation. This amount should be disallowed because NECA has failed to explain its derivation.

[10] See Appendix B, Table 4.

[11] Beginning in 1989, the expense adjustment so calculated is then adjusted annually to reflect changes in the size of the USF due to periodic updates made by LECs during the prior year (Part 36.631(e)).

same time, the USF subsidy of those LECs that did not file quarterly cost updates cannot be affected by this recomputation.[12]

For other types of cost changes (e.g., errors and omissions, adjustments for average schedule to cost conversions, sale of assets, etc.), NECA employs a modified version of the quarterly cost update rule (Part 36.622) under which it recomputes the NACPL only for those LECs whose errata impact on that LEC's study area exceeds $1 million.[13] There are no provisions in the Commission's rules or Orders which expressly sanctions this practice.

NECA's decision to depart from the Commission's rules in its handling of these cost changes creates two major problems which combine to cause an unwarranted growth in the USF. First, most LECs identified as having increased study area loop costs on their errata will have their costs compared to the original NACPL, that is kept artificially

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[12] This is because the rule further provides the new NACPL shall be used to determine the additional interstate expense allocation only for those LECs that filed quarterly cost updates (See Part 36.622(a)(2) and (3)).

[13] See NECA Direct Case, pp. 10-12. For these companies, NECA recomputes the NACPL and based on a comparison of the LEC's revised study area loop costs to the revised NACPL, increases the filing LEC's USF subsidy. For LECs with errata whose impact is less than $1 million on the LEC's study area USF expense adjustment, NECA does not recalculate the NACPL; such companies receive an increased USF subsidy based on a comparison of their revised study area loop cost to the original NACPL. The USF subsidies for LECs that do not file errata are not adjusted.

lower than it would be had NECA not improperly declined to include LEC errata that result in less than a $1 million USF expense cost adjustment. Second, NECA's procedure of recomputing the USF subsidy only for LECs with errata means that all other LECs will continue to receive the full USF subsidy (which was based on a comparison of their loop costs with the original NACPL), despite the fact that the national average loop cost may have increased and that in comparison to the revised NACPL, their USF subsidy would be adjusted downward. To ensure the integrity of USF costs, NECA should treat these non-quarterly adjustments the same as the annual USF recalculation -- taking all costs into account for all LECs and making the study area loop cost-to-NACPL comparison for each LEC on that basis.

As shown in Appendix B, Table 1, NECA's improper procedure for non-quarterly updates has increased USF revenue requirements by approximately $18.1 million for the period 1989-91[14] (as compared to the level at which it would have been had NECA employed the annual USF calculation procedures for non-quarterly resizings).

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[14] 1991 is the base (or "data") year for the establishment of the annual USF rate filing that NECA made in November 1992 to be effective in 1993 (see Part 36.601(b), 36.611(a)). It is NECA's practice to allow LECs to adjust the data underlying the USF calculation for a twenty-four month period prior to the base year. See NECA Direct Case, Appendix 2, USF Internal Procedures, Section IV.G.1, p. 36. Therefore, errors in years 1989, 1990 and/or 1991 data directly impact the 1993 USF rate that is the subject of this investigation.

The primary policy argument that NECA offers to justify the procedures it employs for non-quarterly cost adjustment is without merit. In response to the Designation Order's requirement (¶ 3(f)) that NECA justify "different procedures between NECA's common line pool . . . resizing of the USF fund," NECA essentially argues that USF recipients should not have their USF revenue requirement at risk.[15] However, there is nothing in the Commission's rules or Orders which guarantees LECs the recovery of USF costs, any more than for any other costs.[16]

NECA should be directed to recompute the USF non-quarterly updates based on annual USF calculation procedures. Specifically, NECA should be required to recalculate the NACPL and then compare each LEC's revised local loop cost to the new NACPL to determine whether an increase or decrease in that company's USF subsidy is warranted. This would be consistent with the general requirements for the annual recomputation of USF, which is based on all costs for all LECs and which is designed to

[15] NECA Direct Case, p. 14.

[16] NECA further argues that it would be inconsistent to limit quarterly adjustments solely to the LECs filing those adjustments but not to similarly restrict non-quarterly cost adjustments. NECA Direct Case, p. 13. Assuming that consistency between quarterly and non-quarterly adjustments were desirable (even at the expense of accuracy), NECA's use of a $1 million threshold for recomputing NACPL for non-quarterly adjustments is

ensure that the USF subsidy to which a LEC is entitled accurately reflects actual costs.[17]

NECA should also be required to refund to IXCs all amounts by which the USF rate filed in November 1992 would have been reduced had this procedure been employed. This will result in a reduction of the USF expense adjustment of $18.1 million.

II. NECA'S AUDIT PROCEDURES HAVE FAILED TO DETECT SIGNIFICANT ERRORS IN LEC DATA SUBMISSIONS.

NECA's Direct Case contains numerous examples which demonstrate that NECA has failed to identify and correct errors in data submitted by LECs for inclusion in the USF calculation, contrary to NECA's stated procedures. These examples include failures to: (1) flag incorrect data by hard and soft edit checks; (2) capture by range checks data aberrations which exhibit inordinate period-over-period growth; and make the necessary corrections.

A. Problems With Hard and Soft Edit Checks

NECA data collection procedures specify that Transmission Equipment assigned to the loop (Category 4.13) cannot be greater than the amounts in Total Central Office

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[17] See MTS and WATS Market Structure and Amendment of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Federal-State Joint Board, 3 FCC Rcd. 5518, 5529 (1988). Unless stopped, NECA's practices [illegible]

Transmission - Account 2230. Specifically, the USF Reference Guide describes both hard and soft edits which are not supposed to allow a condition in which there is more Transmission Equipment assigned to the loop (Category 4.13) than there is total Transmission Equipment (Account 2230) on the books of the LEC.[18]

Despite these edit procedures, there exist significant data errors in the latest 1989 and 1990 views of the individual LEC USF Data Collection Forms. In 1990, forty-nine LECs have "latest view" Category 4.13 amounts which were in excess of the total Account 2230 on the LECs' books. Moreover, 1989 was even worse, with sixty-six LECs having "latest view" amounts of Category 4.13 which exceeded the total Account 2230. Clearly, the companies reporting more Category 4.13 than Account 2230 in the 1990 and 1989 "latest views" have assigned excessive Category 4.13 investment in the USF Data Collection. The errors in the Category 4.13 data contained in the latest views of 1989 and 1990 overstate the USF revenue requirement by at least $3.8 million and $3.7 million, respectively.[19] NECA should be ordered to correct its data bases for these errors in

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[18] NECA Direct Case, Appendix 2, USF Reference Guide, Section 3, p. 8.

[19] Appendix C, Section I contains an explanation of the methods used to quantify the $7.5 million overstated USF revenue requirement.

1989 and 1990, and to refund the $7.5 million overcollection

[redacted]

B. Problems With Range Checks

NECA procedures specify range validation techniques to identify substantial variances in data reported by the LECs so that erroneous data may be corrected. Notwithstanding these procedures, an extraordinary increase in New Jersey Bell's Category 4.13 cost was reported in 1991,[24] which should also have been reflected in prior period adjustments for 1989 and 1990.

AT&T's Petition showed that New Jersey Bell's 1990 to 1991 increase of $332.7 million in Transmission Equipment assigned to the loop (Category 4.13) was excessive, particularly in light of the fact total Central Office Transmission Equipment as recorded on the financial books of the company increased only $62.7 million. It further showed that NECA should adjust New Jersey Bell's USF for years 1989-90 to reflect the higher relative percentage of Transmission Equipment supporting the loop.[25]

NECA replied that it was inappropriate to update prior periods because "NJ Bell's policy has always been to introduce basic studies only on a forward going basis."[26] In addition, a letter from Bell Atlantic (included in NECA's reply) explained that the increased level of Category 4.13

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[24] NECA Direct Case, Appendix 2, USF Reference Guide Data Collection, Section 3, p. 14 through Section 5, p. 38.

[25] AT&T Petition, p. 9 n.16 and Appendix E thereto.

[26] NECA Reply, dated December 15, 1992, p. 14.

in 1991 was directly attributable to the same aggressive deployment of subscriber carrier systems (SLC 96) in the local network as in the other Bell Atlantic Companies (and reflected in their separations studies in 1990).[27]

NECA's Direct Case contradicts both of its prior responses. The Direct Case contains additional data which show that for USF purposes the "latest view" of New Jersey Bell's Category 4.13 investment identified in separations studies has been revised from what was submitted by the company to NECA in the original USF Data Collections Forms for calendar years 1989 and 1990,[28] thus negating NECA's prior assertions that such studies are only updated prospectively. Additionally, the Direct Case provides "latest view" data which contradicts New Jersey Bell's assertion that its separations study reflecting aggressive deployment of SLC 96 is similar to that experienced by other been provided to explain why the New Jersey Bell separations study should not be applied to prior periods for purposes of properly resizing the USF 1989 and 1990 adjustment window, the Commission should direct that such an adjustment of prior periods be accomplished, and that NECA refund the $11.0 million overstatement attributable to the 1989 and 1990 periods used to establish the 1993 USF rate.[30]

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[30] Appendix C contains an explanation of the method used to quantify the overstatement of the USF revenue requirement.

CONCLUSION

For reasons stated above and in AT&T's December 2, 1992 Petition, the Commission should require NECA to recompute its 1993 USF rate and to refund the overstated amounts which IXCs have paid during the pendency of this investigation.

Respectfully submitted,

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BREAKDOWN OF 11/92 USF FILING AMOUNTS
THAT SHOULD BE DISALLOWED AND REFUNDED TO IXCS[1]

($ Millions)

Unexplained Resizings	14.6
Recast of 1989-91 per Designation Order	18.1
Category 4.13 Overstatements	7.5[2]
Category 1 Overstatement	5.6[2]
New Jersey Bell Overstatement	11.8[2]
Anomously High Growth in	33.7[3]

TABLE 1

SUMMARY OF USF RECALCULATED EXPENSE ADJUSTMENTS FOR 1984 - 1991

($ Millions)

DATA Year	NECA'S ORIGINAL OFFICIAL VIEW FILING NACPL	Exp. Adj	Payment	NECA'S DIRECT CASE LATEST VIEW (4/93) NACPL	Exp. Adj*	Payment	NECA'S RECAST ANALYSIS BASED ON DESIGNATION ORDER NACPL	Exp. Adj	Payment	NET IMPACT OF RECAST ANALYSIS Exp. Adj	Payment
1984	213.37	446.0	55.8	211.56	435.2	54.4	211.56	435.9	54.5	0.7	0.1
1985	220.25	483.1	120.8	219.70	472.1	118.0	219.70	482.5	120.6	10.4	2.6
1986	231.57	478.4	179.4	231.10	475.5	178.3	231.10	478.8	179.6	3.3	1.3

TABLE 2

ANNUAL USF EXPENSE ADJUSTMENT GROWTH VS RESIZING GROWTH
FROM NECA SEMI-ANNUAL FILINGS 11/90 THROUGH 5/93

($000)

LINE	ITEM	11/90 A	5/91 B	11/91 C	5/92 D	11/92 E	5/93 F
1	Annual USF Expense Adjustment	629,157	n/a	671,889	n/a	699,055	n/a
2	Year-Over-Year Difference	86,431		42,732		27,166	
3	Reported Resizing	-4,387	5,019	2,448	6,212	14,590	14,431
4	Total Yearly Resizing		632		8,660		29,021

TABLE 3